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In addition to nonperforming assets in the table above, we monitor loans where a borrower's past credit history casts doubt on their ability to repay a loan ("Special Mention" loans). Special Mention loans represented \$397.1 million, or 1%, and \$261.5 million, or 1%, of the total loan portfolio at June 30, 2007 and December 31, 2006, respectively, and are generally secured by real estate assets, reducing the potential loss should they become non-performing. These loans are actively monitored, continue to accrue interest and remain a component of the loans receivable balance. The increase in Special Mention loans was due primarily to an increase in the 30-day delinquency category of real estate loans. We expect migration from this category to more serious delinquency classifications to increase over time consistent with the current instability in the overall consumer credit market.

***Available-for-Sale Mortgage-Backed and Investment Securities***

Available-for-sale securities are summarized as follows (dollars in thousands):

	June 30, 2007	December 31, 2006	Variance 2007 vs. 2006
<b>Mortgage-backed securities:</b>			
Backed by U.S. government sponsored and Federal agencies	\$10,610,913	\$ 9,109,307	16 %
Collateralized mortgage obligations and other	<u>1,552,970</u>	<u>1,108,385</u>	40 %
Total mortgage-backed securities	<u>12,163,883</u>	<u>10,217,692</u>	19 %
<b>Investment securities:</b>			
Asset-backed securities	2,957,963	2,161,728	37 %
Publicly traded equity securities:			
Preferred stock	461,607	458,674	1 %
Corporate investments	13,757	24,139	(43)%
FHLB stock	347,992	244,212	42 %
Other	948,046	815,538	16 %
Total investment securities	<u>4,729,365</u>	<u>3,704,291</u>	28 %
Total available-for-sale securities	<u>\$16,893,248</u>	<u>\$13,921,983</u>	21 %

Available-for-sale securities represented 27% and 26% of total assets at June 30, 2007 and December 31, 2006, respectively. Available-for-sale securities increased 21% to \$16.9 billion at June 30, 2007 compared to December 31, 2006, due primarily to the growth in our mortgage-backed securities portfolio. Substantially all mortgage-backed securities backed by U.S. Government sponsored and Federal agencies are "AAA" rated and the majority of the asset-backed securities portfolio consisted of "AA" or higher rated securities. We evaluate our available-for-sale securities in light of changing market conditions and other factors and, where appropriate, take steps intended to improve our overall position. Based on this evaluation, we decided to grow the mortgage-backed and asset-backed securities portfolios, which resulted in an increase of \$2.7 billion in these portfolios during the six months ended June 30, 2007.

As interest rates increase, the fair value of fixed-rate available-for-sale securities decreases and vice versa. The fair value of the portfolio will be adversely impacted in the future if long-term interest rates continue to rise. Net unrealized gains and losses in available-for-sale securities are included in shareholders' equity as accumulated other comprehensive income or loss, net of tax.

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### Deposits

Deposits are summarized as follows (dollars in thousands):

	June 30, 2007	December 31, 2006	<u>Variance</u> <u>2007 vs. 2006</u>
Sweep deposit accounts	\$10,995,856	\$10,837,124	1 %
Money market and savings accounts	11,354,555	7,634,241	49 %
Certificates of deposit <sup>(1)</sup>	4,617,397	4,737,253	(3)%
Brokered certificates of deposit <sup>(2)</sup>	406,802	483,777	(16)%
Checking accounts	396,139	378,617	5 %
Total deposits	<u>\$27,770,749</u>	<u>\$24,071,012</u>	15 %

<sup>(1)</sup> Represents retail certificates of deposit including retail brokered certificates of deposit.

<sup>(2)</sup> Represents institutional certificates of deposit.

Deposits represented 47% and 49% of total liabilities at June 30, 2007 and December 31, 2006, respectively. Deposits increased \$3.7 billion to \$27.8 billion at June 30, 2007 compared to December 31, 2006, driven by a \$3.7 billion increase in money market and savings accounts.

The increase in deposits is primarily the result of the growth in our Complete Savings Account. This new product has driven measurable growth in cash from new and existing customers. Deposits generally provide us the benefit of lower interest costs, compared with wholesale funding alternatives.

The deposits balance is a component of the total customer cash and deposits balance reported as a customer activity metric of \$37.9 billion for the six months ended June 30, 2007. The total customer cash and deposits balance is summarized as follows (dollars in thousands):

	June 30, 2007	December 31, 2006	<u>Variance</u> <u>2007 vs. 2006</u>
Deposits	\$27,770,749	\$24,071,012	15 %
Less: brokered certificates of deposit	<u>(406,802)</u>	<u>(483,777)</u>	(16)%
Deposits excluding brokered certificates of deposit	27,363,947	23,587,235	16 %
Customer payables	6,493,401	6,182,672	5 %
Customer cash balances held by third parties and other	4,065,512	3,819,860	6 %
Total customer cash and deposits	<u>\$37,922,860</u>	<u>\$33,589,767</u>	13 %

### Securities Sold Under Agreements to Repurchase and Other Borrowings

Securities sold under agreements to repurchase and other borrowings are summarized as follows (dollars in thousands):

	June 30, 2007	December 31, 2006	<u>Variance</u> <u>2007 vs. 2006</u>
Securities sold under agreements to repurchase	\$12,435,733	\$ 9,792,422	27%
FHLB advances	\$ 7,174,147	\$ 4,865,466	47%
Subordinated debentures	435,830	385,502	13%
Other	<u>175,124</u>	<u>72,994</u>	140%

Total other borrowings	<u>\$ 7,785,101</u>	<u>\$ 5,323,962</u>	46%
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Securities sold under agreements to repurchase increased by 27% at June 30, 2007 compared to December 31, 2006. Securities sold under agreements to repurchase coupled with FHLB advances are the primary wholesale funding sources of the Bank. The Bank used these wholesale sources along with deposit growth to fund the increase in loans receivable. Other borrowings represented 13% and 11% of total liabilities at June 30, 2007 and December 31, 2006, respectively. The increase of \$2.5 billion during the six months ended June 30, 2007 was due primarily to an increase in FHLB advances. We actively manage our funding sources and determine the optimal mix based on pricing, liquidity and capacity during each period.

## LIQUIDITY AND CAPITAL RESOURCES

Our liquidity and capital resources enable us to fund our operating activities, finance acquisitions and grow our assets. Cash flows are derived from our operations in the retail and institutional segments and our capital market activities. The segment cash flows provide capital to fund growth in our regulated subsidiaries. The Company's cash and equivalents balance decreased to \$1.0 billion for the period ended June 30, 2007.

### *Corporate Debt*

Our current senior debt ratings are Ba2 (positive outlook) by Moody's Investor Service, BB- (stable) by Standard & Poor's and BB (high) by Dominion Bond Rating Service ("DBRS"). The Company's long-term deposit ratings are Baa3 (positive outlook) by Moody's Investor Service, BB+ (stable) by Standard & Poor's and BBB (low) by DBRS. A significant change in these ratings may impact the rate and availability of future borrowings.

### *Liquidity Available from Subsidiaries*

Liquidity available to the Company from its subsidiaries, other than Converging Arrows, Inc. ("Converging Arrows"), is limited by regulatory requirements. Converging Arrows is a subsidiary of the parent company. At June 30, 2007, Converging Arrows had \$57.1 million of cash and investment securities available as a source of liquidity for the parent company. Converging Arrows is not restricted in its dealings with the parent company and may transfer funds to the parent company without regulatory approval. In addition to Converging Arrows, brokerage and banking subsidiaries may provide liquidity to the parent; however, they are restricted by regulatory guidelines.

E\*TRADE Bank is prohibited by regulations from lending to the parent company. At June 30, 2007, E\*TRADE Bank had approximately \$221.1 million of capital available for dividend declaration without regulatory approval while still maintaining "well capitalized" status. E\*TRADE Bank is also required by Office of Thrift Supervision ("OTS") regulations to maintain tangible capital of at least 1.50% of tangible assets. E\*TRADE Bank satisfied this requirement at June 30, 2007 and December 31, 2006.

Brokerage subsidiaries are required to maintain net capital equal to the greater of \$250,000 or 2% of aggregate debit balances arising from customer transactions. At June 30, 2007 and December 31, 2006, all of our brokerage subsidiaries met their minimum net capital requirements. The Company's broker-dealer subsidiaries had excess net capital of \$686.0 million at June 30, 2007.

### *Other Sources of Liquidity*

We maintain committed financing facilities with banks totaling \$250.0 million<sup>(1)</sup> to meet corporate liquidity needs and \$576.0 million in uncommitted financing to meet margin lending needs. There were no outstanding balances, and the full \$826.0 million was available under these lines at June 30, 2007 and December 31, 2006.

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<sup>(1)</sup> The committed financing facility was amended in July 2007, improving the terms and conditions as well as extending the maturity of the credit facility to September 2010. See Note 19—Subsequent Events.

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We rely on borrowed funds, such as FHLB advances and securities sold under agreements to repurchase, to provide liquidity for the Bank. At June 30, 2007, the Bank had approximately \$10.1 billion in additional borrowing capacity.

### ***Other Liquidity Matters***

We currently anticipate that our available cash resources and credit will be sufficient to meet our anticipated working capital and capital expenditure requirements for at least the next 12 months. We may need to raise additional funds in order to support more rapid expansion, develop new or enhanced products and services, respond to competitive pressures, acquire businesses or technologies or take advantage of unanticipated opportunities.

### **SUMMARY OF CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

The preparation of our financial condition and results of operations requires us to make judgments and estimates that may have a significant impact upon the financial results of the Company. We believe that of our significant accounting policies, the following require estimates and assumptions that require complex, subjective judgments by management, which can materially impact reported results: allowance for loan losses and uncollectible margin loans; classification and valuation of certain investments; valuation and accounting for financial derivatives; estimates of effective tax rate; deferred taxes and valuation allowances; and valuation of goodwill and other intangibles. These are more fully described in "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K for the year ended December 31, 2006.

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### GLOSSARY OF TERMS

*Active Trader*—The customer segment that includes those who execute 30 or more trades per quarter.

*Adjusted total assets*—Bank-only assets composed of total assets plus/(less) unrealized losses (gains) on available-for-sale securities, less deferred tax assets, goodwill and certain other intangible assets.

*Average commission per trade*—Total retail segment commission revenue divided by total number of retail trades.

*Average equity to average total assets*—Average total shareholders' equity divided by average total assets.

*Bank*—ETB Holdings, Inc. (“ETBH”), the entity that is our bank holding company and parent to E\*TRADE Bank and E\*TRADE Global Asset Management, Inc. (“ETGAM”).

*Basis point*—One one-hundredth of a percentage point.

*Cash flow hedge*—A financial derivative instrument designated in a hedging relationship that mitigates exposure to variability in expected future cash flows attributable to a particular risk.

*Charge-off*—The result of removing a loan or portion of a loan from an entity's balance sheet because the loan is considered to be uncollectible.

*Compensation and benefits as a percentage of revenue*—Total compensation and benefits expense divided by total net revenue.

*Contract for difference (“CFDs”)*—A derivative based on an underlying stock or index that covers the difference between the nominal value at the opening of a trade and at the close of a trade. A CFD is researched and traded in the same manner as a stock.

*Corporate investments*—Primarily equity investments held at the parent company level that are not related to the ongoing business of the Company's operating subsidiaries.

*Customer cash and deposits*—Customer cash, deposits, customer payables and money market balances, including those held by third parties.

*Daily average revenue trades (“DARTs”)*—Total revenue trades in a period divided by the number of trading days during that period.

*Derivative*—A financial instrument or other contract the price of which is directly dependent upon the value of one or more underlying securities, interest rates or any agreed upon pricing index. Derivatives cover a wide assortment of financial contracts, including forward contracts, options and swaps.

*E\*TRADE Complete*—An integrated trading, investing, banking and lending product that allows customers to manage their relationships with the Company through one account. E\*TRADE Complete helps customers optimize cash and credit by utilizing tools designed to inform them of whether or not they are receiving the most appropriate rates for their cash and paying the most appropriate rates for credit.

*Enterprise interest-bearing liabilities*—Liabilities such as customer deposits, repurchase agreements, other borrowings and advances from the FHLB, certain customer credit balances and stock loan programs on which the Company pays interest; excludes customer money market balances held by third parties.

*Enterprise interest-earning assets*—Consists of the primary interest-earning assets of the Company and includes: loans receivable, mortgage-backed and available-for-sale securities, margin receivables, stock borrow balances, and cash required to be segregated under regulatory guidelines that earn interest for the Company.

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*Enterprise net interest income*—The taxable equivalent basis net operating interest income excluding corporate interest income and corporate interest expense, stock conduit interest income and expense and interest earned on customer cash held by third parties.

*Enterprise net interest spread*—The taxable equivalent rate earned on average enterprise interest-earning assets less the rate paid on average enterprise interest-bearing liabilities, excluding corporate interest-earning assets and liabilities, stock conduit and cash held by third parties.

*Exchange-traded funds*—A fund that invests in a group of securities and trades like an individual stock on an exchange.

*Fair value hedge*—A financial derivative instrument designated in a hedging relationship that mitigates exposure to changes in the fair value of a recognized asset or liability or a firm commitment.

*Generally Accepted Accounting Principles ("GAAP")*—Accounting principles generally accepted in the United States of America.

*Interest rate cap*—An options contract that puts an upper limit on a floating exchange rate. The writer of the cap has to pay the holder of the cap the difference between the floating rate and the upper limit when that upper limit is breached. There is usually a premium paid by the buyer of such a contract.

*Interest rate floor*—An options contract that puts a lower limit on a floating exchange rate. The writer of the floor has to pay the holder of the floor the difference between the floating rate and the lower limit when that lower limit is breached. There is usually a premium paid by the buyer of such a contract.

*Interest rate swaps*—Contracts that are entered into primarily as an asset/liability management strategy to reduce interest rate risk. Interest rate swap contracts are exchanges of interest rate payments, such as fixed-rate payments for floating-rate payments, based on notional principal amounts.

*Main Street Investor*—The customer segment that includes those who execute less than 30 trades per quarter and hold less than \$50,000 in assets in combined retail accounts.

*Margin debt*—The extension of credit to brokerage customers of the Company, on and off balance sheet, where the loan is secured with securities owned by the customer.

*Mass Affluent*—The customer segment that includes those who hold \$50,000 or more in assets in combined retail accounts.

*Net Present Value of Equity ("NPVE")*—The present value of expected cash inflows from existing assets, minus the present value of expected cash outflows from existing liabilities, plus the expected cash inflows and outflows from existing derivatives and forward commitments. This calculation is performed for E\*TRADE Bank.

*Nonperforming assets*—Assets that do not earn income, including those originally acquired to earn income (delinquent loans) and those not intended to earn income (REO). Loans are classified as nonperforming when full and timely collection of interest and principal becomes uncertain or when the loans are 90 days past due.

*Notional amount*—The specified dollar amount underlying a derivative on which the calculated payments are based.

*Operating expenses*—Total expense excluding interest, as shown on the Company's consolidated statement of income.

*Operating margin*—Income before other income (expense), income taxes and discontinued operations.

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*Operating margin (%)*—Percentage of net revenue that goes to income before other income (expense), income taxes and discontinued operations. It is calculated by dividing our income before other income (expense), income taxes and discontinued operations by our total net revenue.

*Options*—Contracts that grant the purchaser, for a premium payment, the right, but not the obligation, to either purchase or sell the associated financial instrument at a set price during a period or at a specified date in the future.

*Organic*—Business related to new and existing customers as opposed to acquisitions.

*Principal transactions*—Transactions that primarily consist of revenue from market-making activities.

*Real-estate owned repossessed assets (“REO”)*—Ownership of real property by the Company, generally acquired as a result of foreclosure.

*Repurchase agreement*—An agreement giving the seller of an asset the right or obligation to buy back the same or similar securities at a specified price on a given date. These agreements are generally collateralized by mortgage-backed or investment-grade securities.

*Retail client assets*—Market value of all client assets held by the Company including security holdings, customer cash and deposits and vested unexercised options.

*Retail deposits*—Balances of retail customer cash held at the Bank; excludes brokered certificates of deposit.

*Return on average total assets*—Annualized net income from continuing operations divided by average assets.

*Return on average total shareholders’ equity*—Annualized net income from continuing operations divided by average shareholders’ equity.

*Revenue growth*—The difference between the current and prior comparable period total net revenue divided by the prior comparable period total net revenue.

*Risk-weighted assets*—Primarily computed by the assignment of specific risk-weightings assigned by the OTS to assets and off-balance sheet instruments for capital adequacy calculations. This calculation is for E\*TRADE Bank only.

*Stock conduit*—The borrowing of shares from a Broker-Dealer and subsequently lending the same shares to another Broker-Dealer netting a fee.

*Sweep deposit accounts*—Accounts with the functionality to transfer brokerage cash balances to and from an FDIC-insured money market account at the Bank.

*Taxable equivalent interest adjustment*—The operating interest income earned on certain assets is completely or partially exempt from federal and/or state income tax. As such, these tax-exempt instruments typically yield lower returns than a taxable investment. To provide more meaningful comparison of yields and margins for all interest-earning assets, the interest income earned on tax exempt assets is increased to make it fully equivalent to interest income on other taxable investments. This adjustment is done for the analytic purposes in the net enterprise interest income/spread calculation and is not made on the consolidated statement of income, as that is not permitted under GAAP.

*Tier 1 Capital*—Adjusted equity capital used in the calculation of capital adequacy ratios at E\*TRADE Bank as required by the OTS. Tier 1 capital equals: total shareholder’s equity at E\*TRADE Bank, plus/(less) unrealized losses (gains) on available-for-sale securities and cash flow hedges, less deferred tax assets, goodwill and certain other intangible assets.



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### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The following discussion about our market risk disclosure includes forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements as a result of certain factors, including, but not limited to, those set forth in Item 1A. "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2006 and as updated in this report. Market risk is our exposure to changes in interest rates, foreign exchange rates and equity and commodity prices. Our exposure to interest rate risk is related primarily to interest-earning assets and interest-bearing liabilities.

#### ***Interest Rate Risk***

The management of interest rate risk is essential to profitability. Interest rate risk is our exposure to changes in interest rates. In general, we manage our interest rate risk by balancing variable-rate and fixed-rate assets and liabilities and we utilize derivatives in a way that reduces our overall exposure to changes in interest rates. In recent years, we have managed our interest rate risk to achieve a minimum to moderate risk profile with limited exposure to earnings volatility resulting from interest rate fluctuations. Exposure to interest rate risk requires management to make complex assumptions regarding maturities, market interest rates and customer behavior. Changes in interest rates, including the following, could impact interest income and expense:

- Interest-earning assets and interest-bearing liabilities may re-price at different times or by different amounts creating a mismatch.
- The yield curve may flatten or change shape affecting the spread between short- and long-term rates. Widening or narrowing spreads could impact net interest income.
- Market interest rates may influence prepayments resulting in maturity mismatches. In addition, prepayments could impact yields as premium and discounts amortize.

Exposure to market risk is dependent upon the distribution and composition of interest-earning assets, interest-bearing liabilities and derivatives. The differing risk characteristics of each product are managed to mitigate our exposure to interest rate fluctuations. At June 30, 2007, 93% of our total assets were enterprise interest-earning assets.

At June 30, 2007, approximately 70% of our total assets were residential real estate loans and available-for-sale mortgage-backed and asset-backed securities. The values of these assets are sensitive to changes in interest rates, as well as expected prepayment levels. As interest rates increase, fixed rate residential real estate loans and mortgage-backed securities tend to exhibit lower prepayments. The inverse is true in a falling rate environment.

When real estate loans prepay, unamortized premiums are written off. Depending on the timing of the prepayment, the write-offs of unamortized premiums may result in lower than anticipated yields. E\*TRADE Bank's Asset Liability Committee ("ALCO") reviews estimates of the impact of changing market rates on loan production volumes and prepayments. This information is incorporated into our interest rate risk management strategy.

We held \$161.9 million in trading securities as of June 30, 2007. These securities and the associated interest rate risk are not material to the Company's financial position, results of operations, or cash flows.

Our liability structure consists of transactional deposit relationships, such as savings and money market accounts; certificates of deposit; securities sold under agreements to repurchase; customer payables; wholesale collateralized borrowings from the FHLB and other entities; and long term notes. Our transactional deposit accounts and customer payables tend to be less rate-sensitive than wholesale borrowings. Agreements to repurchase securities and money market accounts re-price as interest rates change. Certificates of deposit re-price over time depending on maturities. FHLB advances and long-term notes generally have fixed rates.

**Table of Contents*****Derivative Financial Instruments***

We use derivative financial instruments to help manage our interest rate risk. Interest rate swaps involve the exchange of fixed-rate and variable-rate interest payments between two parties based on a contractual underlying notional amount, but do not involve the exchange of the underlying notional amounts. Option products are utilized primarily to decrease the market value changes resulting from the prepayment dynamics of the mortgage portfolio, as well as to protect against increases in funding costs. The types of options employed include Cap Options (“Caps”) and Floor Options (“Floors”), Payor Swaptions and Receiver Swaptions. Caps mitigate the market risk associated with increases in interest rates while Floors mitigate the risk associated with decreases in market interest rates. Similarly, Payor and Receiver Swaptions mitigate the market risk associated with the respective increases and decreases in interest rates. See derivative financial instruments discussion at Note 7—Accounting for Derivative Financial Instruments and Hedging Activities in Item 1. Consolidated Financial Statements.

For mortgage loans intended to be sold, Interest Rate Lock Commitments (“IRLCs”) are considered derivatives with changes in fair value recorded in earnings. IRLCs are commitments issued to borrowers that lock in an interest rate now for a loan closing in one to three months. These locks, initially recorded with a fair value of zero, will fluctuate in value during the lock period as market interest rates change. See mortgage banking activities discussion at Note 7—Accounting for Derivative Financial Instruments and Hedging Activities in Item 1. Consolidated Financial Statements.

***Scenario Analysis***

Scenario analysis is an advanced approach to estimating interest rate risk exposure. Under the Net Present Value of Equity (“NPVE”) approach, the present value of all existing assets, liabilities, derivatives and forward commitments are estimated and then combined to produce a NPVE figure. The sensitivity of this value to changes in interest rates is then determined by applying alternative interest rate scenarios, which include, but are not limited to, instantaneous parallel shifts up 100, 200 and 300 basis points and down 100 and 200 basis points. The NPVE method is used at the E\*TRADE Bank level and not for the Company. During the first quarter of 2007, E\*TRADE Clearing LLC (“ETC”) became a wholly-owned operating subsidiary of E\*TRADE Bank.

E\*TRADE Bank has 95% and 81% of our enterprise interest-earning assets at June 30, 2007 and December 31, 2006, respectively, and holds 95% and 79% of our enterprise interest-bearing liabilities at June 30, 2007 and December 31, 2006, respectively. The sensitivity of NPVE at June 30, 2007 and December 31, 2006 and the limits established by E\*TRADE Bank’s Board of Directors are listed below (dollars in thousands):

Parallel Change in Interest Rates (bps)	Change in NPVE				
	June 30, 2007 <sup>(1)</sup>		December 31, 2006		Board Limit
	Amount	Percentage	Amount	Percentage	
+300	\$ (466,608)	(12)%	\$ (52,325)	(2)%	(55)%
+200	\$ (287,178)	(7)%	\$ (32,680)	(1)%	(30)%
+100	\$ (153,897)	(4)%	\$ (15,303)	(1)%	(20)%
-100	\$ 84,004	2 %	\$ (159,618)	(6)%	(20)%
-200	\$ (95,405)	(2)%	\$ (560,142)	(20)%	(30)%

<sup>(1)</sup> Amounts and percentages include ETC.

Under criteria published by the OTS, E\*TRADE Bank’s overall interest rate risk exposure at June 30, 2007 was characterized as “minimum.” We actively manage our interest rate risk positions. As interest rates change, we will re-adjust our strategy and mix of assets, liabilities and derivatives to optimize our position. For example, a 100 basis points increase in rates may not result in a change in value as indicated above. The ALCO monitors E\*TRADE Bank’s interest rate risk position.



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### ***Other Market Risk***

#### ***Equity Security Risk***

Equity securities risk is the risk of potential loss from investing in public and private equity securities including foreign currency exchange risk. We hold equity securities for investment purposes and in trading securities for market-making purposes. The foreign currency exchange risk associated with these investments is not material to the Company. For investment purposes, we currently hold publicly traded equity securities, in which we had gross unrealized gains of \$4.6 million as of June 30, 2007. As each security's market price fluctuates, we are exposed to risk of a loss with respect to these unrealized gains. See publicly traded equity securities discussion at Note 5—Available-for-Sale Mortgage-Backed and Investment Securities in Item 1. Consolidated Financial Statements.

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### PART I—FINANCIAL INFORMATION

#### ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

#### E\*TRADE FINANCIAL CORPORATION AND SUBSIDIARIES CONSOLIDATED STATEMENT OF INCOME (In thousands, except per share amounts) (Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Revenue:				
Operating interest income	\$ 905,772	\$ 660,373	\$ 1,735,567	\$ 1,254,667
Operating interest expense	(491,608)	(315,771)	(930,817)	(585,276)
Net operating interest income	414,164	344,602	804,750	669,391
Provision for loan losses	(30,045)	(10,270)	(51,231)	(20,467)
Net operating interest income after provision for loan losses	384,119	334,332	753,519	648,924
Commission	169,768	167,296	328,761	343,165
Fees and service charges	65,446	57,809	124,944	115,671
Principal transactions	27,768	31,590	57,850	62,282
Gain on sales of loans and securities, net	5,328	11,107	22,703	22,735
Other revenue	11,120	9,224	20,770	16,930
Total non-interest income	279,430	277,026	555,028	560,783
Total net revenue	663,549	611,358	1,308,547	1,209,707
Expense excluding interest:				
Compensation and benefits	119,079	125,641	242,861	241,629
Clearing and servicing	74,177	64,138	141,429	127,426
Advertising and market development	35,938	30,420	81,530	65,201
Communications	25,821	27,834	51,977	59,242
Professional services	25,162	23,219	50,147	50,974
Depreciation and amortization	20,075	18,827	39,458	37,616
Occupancy and equipment	22,820	20,428	46,399	40,932
Amortization of other intangibles	10,187	11,972	20,455	23,304
Facility restructuring and other exit activities	(1,500)	2,884	(767)	2,631
Other	70,426	25,208	103,101	56,213
Total expense excluding interest	402,185	350,571	776,590	705,168
Income before other income (expense), income taxes and discontinued operations	261,364	260,787	531,957	504,539
Other income (expense):				
Corporate interest income	1,001	2,188	2,706	4,149
Corporate interest expense	(37,866)	(36,114)	(75,657)	(76,622)
Gain on sales and impairment of investments	17,267	15,290	37,023	32,906
Gain (loss) on early extinguishment of debt	31	(568)	31	(703)
Equity in (loss) income of investments and venture funds	(840)	189	7,255	(818)
Total other income (expense)	(20,407)	(19,015)	(28,642)	(41,088)
Income before income taxes and discontinued operations	240,957	241,772	503,315	463,451
Income tax expense	81,828	85,080	174,776	163,775
Net income from continuing operations	159,129	156,692	328,539	299,676
Loss from discontinued operations, net of tax	—	(208)	—	(721)
Net income	\$ 159,129	\$ 156,484	\$ 328,539	\$ 298,955
Basic earnings per share from continuing operations	\$ 0.38	\$ 0.37	\$ 0.78	\$ 0.72
Basic loss per share from discontinued operations	—	(0.00)	—	(0.00)
Basic net earnings per share	\$ 0.38	\$ 0.37	\$ 0.78	\$ 0.72
Diluted earnings per share from continuing operations	\$ 0.37	\$ 0.36	\$ 0.75	\$ 0.69
Diluted loss per share from discontinued operations	—	(0.00)	—	(0.00)
Diluted net earnings per share	\$ 0.37	\$ 0.36	\$ 0.75	\$ 0.69
Shares used in computation of per share data:				

Basic	423,308	421,929	423,546	418,324
Diluted	435,775	439,460	436,708	435,918

See accompanying notes to consolidated financial statements

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**E\*TRADE FINANCIAL CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEET**  
*(In thousands, except share amounts)*  
*(Unaudited)*

	<u>June 30, 2007</u>	<u>December 31, 2006</u>
<b>ASSETS</b>		
Cash and equivalents	\$ 1,039,510	\$ 1,212,234
Cash and investments required to be segregated under Federal or other regulations	352,518	281,622
Trading securities	161,851	178,600
Available-for-sale mortgage-backed and investment securities (includes securities pledged to creditors with the right to sell or repledge of \$13,695,233 at June 30, 2007 and \$11,087,961 at December 31, 2006)	16,893,248	13,921,983
Loans held-for-sale	242,269	283,496
Margin receivables	7,399,916	6,828,448
Loans receivable, net (net of allowance for loan losses of \$75,704 at June 30, 2007 and \$67,628 at December 31, 2006)	31,483,530	26,372,697
Property and equipment, net	363,349	318,389
Goodwill	2,036,920	2,072,920
Other intangibles, net	451,528	471,933
Other assets	2,550,427	1,796,981
Total assets	<u>\$62,975,066</u>	<u>\$53,739,303</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Liabilities:</b>		
Deposits	\$27,770,749	\$24,071,012
Securities sold under agreements to repurchase	12,435,733	9,792,422
Customer payables	6,493,401	6,182,672
Other borrowings	7,785,101	5,323,962
Senior notes	1,396,906	1,401,592
Mandatory convertible notes	443,071	440,577
Accounts payable, accrued and other liabilities	2,315,943	2,330,696
Total liabilities	<u>58,640,904</u>	<u>49,542,933</u>
<b>Shareholders' equity:</b>		
Common stock, \$0.01 par value, shares authorized: 600,000,000; shares issued and outstanding: 425,256,687 at June 30, 2007 and 426,304,136 at December 31, 2006	4,253	4,263
Additional paid-in capital ("APIC")	3,146,768	3,184,290
Retained earnings	1,522,925	1,209,289
Accumulated other comprehensive loss	(339,784)	(201,472)
Total shareholders' equity	<u>4,334,162</u>	<u>4,196,370</u>
Total liabilities and shareholders' equity	<u>\$62,975,066</u>	<u>\$53,739,303</u>

See accompanying notes to consolidated financial statements



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**E\*TRADE FINANCIAL CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME**  
**(In thousands)**  
**(Unaudited)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Net income	\$ 159,129	\$ 156,484	\$ 328,539	\$ 298,955
Other comprehensive loss				
Available-for-sale securities:				
Unrealized losses, net	(199,636)	(125,208)	(192,747)	(181,891)
Less impact of realized gains (transferred out of accumulated other comprehensive loss) and included in net income, net	<u>(9,653)</u>	<u>(14,695)</u>	<u>(20,821)</u>	<u>(27,523)</u>
Net change from available-for-sale securities	<u>(209,289)</u>	<u>(139,903)</u>	<u>(213,568)</u>	<u>(209,414)</u>
Cash flow hedging instruments:				
Unrealized gains, net	63,494	75,209	62,370	150,743
Reclassifications into earnings, net	<u>170</u>	<u>1,824</u>	<u>358</u>	<u>5,080</u>
Net change from cash flow hedging instruments	<u>63,664</u>	<u>77,033</u>	<u>62,728</u>	<u>155,823</u>
Foreign currency translation gains	15,391	3,668	12,528	5,577
Other comprehensive loss	<u>(130,234)</u>	<u>(59,202)</u>	<u>(138,312)</u>	<u>(48,014)</u>
Comprehensive income	<u>\$ 28,895</u>	<u>\$ 97,282</u>	<u>\$ 190,227</u>	<u>\$ 250,941</u>

See accompanying notes to consolidated financial statements

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**E\*TRADE FINANCIAL CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY**  
 (In thousands)  
 (Unaudited)

	<b>Common Stock</b>		<b>Additional Paid-in Capital</b>	<b>Retained Earnings</b>	<b>Accumulated Other Comprehensive Loss</b>	<b>Total Shareholders' Equity</b>
	<b>Shares</b>	<b>Amount</b>				
Balance, December 31, 2006	426,304	\$ 4,263	\$3,184,290	\$1,209,289	\$ (201,472)	\$ 4,196,370
Cumulative effect of adoption of FIN 48	—	—	—	(14,903)	—	(14,903)
Adjusted balance	426,304	4,263	3,184,290	1,194,386	(201,472)	4,181,467
Net income	—	—	—	328,539	—	328,539
Other comprehensive loss	—	—	—	—	(138,312)	(138,312)
Exercise of stock options and purchase plans, including tax benefit	2,672	27	37,664	—	—	37,691
Repurchases of common stock	(4,159)	(42)	(95,863)	—	—	(95,905)
Issuance of restricted stock	674	7	(7)	—	—	—
Cancellation of restricted stock	(159)	(2)	2	—	—	—
Retirement of restricted stock to pay taxes	(172)	(2)	(3,979)	—	—	(3,981)
Amortization of deferred stock compensation to APIC under SFAS No. 123(R)	—	—	22,449	—	—	22,449
Other	97	2	2,212	—	—	2,214
Balance, June 30, 2007	<u>425,257</u>	<u>\$ 4,253</u>	<u>\$3,146,768</u>	<u>\$1,522,925</u>	<u>\$ (339,784)</u>	<u>\$ 4,334,162</u>
	<b>Common Stock</b>		<b>Additional Paid-in Capital</b>	<b>Retained Earnings</b>	<b>Accumulated Other Comprehensive Loss</b>	<b>Total Shareholders' Equity</b>
	<b>Shares</b>	<b>Amount</b>				
Balance, December 31, 2005	416,582	\$ 4,166	\$2,990,676	\$580,430	\$ (175,712)	\$ 3,399,560
Net income	—	—	—	298,955	—	298,955
Other comprehensive loss	—	—	—	—	(48,014)	(48,014)
Exercise of stock options and warrants, including tax benefit	3,145	31	44,170	—	—	44,201
Issuance of common stock upon conversion of 6% convertible debt	7,772	78	183,333	—	—	183,411
Repurchases of common stock	(2,030)	(20)	(48,253)	—	—	(48,273)
Issuance of restricted stock	620	6	(6)	—	—	—
Cancellation of restricted stock	(83)	(1)	1	—	—	—
Retirement of restricted stock to pay taxes	(82)	(1)	(1,969)	—	—	(1,970)
Amortization of deferred stock compensation to APIC under SFAS No. 123(R)	—	—	19,230	—	—	19,230
Other	—	—	(115)	—	—	(115)
Balance, June 30, 2006	<u>425,924</u>	<u>\$ 4,259</u>	<u>\$3,187,067</u>	<u>\$879,385</u>	<u>\$ (223,726)</u>	<u>\$ 3,846,985</u>

See accompanying notes to consolidated financial statements

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